AN INTERPLAY BETWEEN LIQUIDATION AND ARBITRATION: MALAYSIAN COURT OF APPEAL'S STANCE

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INTRODUCTION

In the realm of construction and commercial contracts, arbitration is a common and preferred mechanism for dispute resolution due to the advantages of party autonomy, confidentiality, speed and finality. However, when a party to an arbitration agreement enters into liquidation, question arises as to the enforceability of such arbitration agreement.

The Malaysian Court of Appeal in the recent case of *Peninsula Education (Setia Alam) Sdn Bhd (Previously Known As Segi International Learning Alliance Sdn Bhd) v Biaxis (M) Sdn Bhd (In Liquidation)* [2024] MLJU 1896 held that arbitration agreement does not automatically become inoperative upon a party going into liquidation. The Court would lean towards upholding the parties' contractual bargains to resolve disputes by arbitration.

BACKGROUND

A contractor appointed under a PAM standard form contract entered into liquidation, leading the employer to terminate the contractor's employment under the contract. The contractor then filed a suit in the High Court to recover amounts due under several interim payment certificates. The contract between the parties includes an arbitration agreement. The employer contested the contractor's claim and applied for a stay of the court proceedings pending arbitration under s. 10 of the Arbitration Act 2005 ("**AA 2005**"). The contractor's liquidator argued that the arbitration agreement had become inoperable due to the liquidation and that the high costs associated with arbitration would justify a refusal of a stay under s. 10 of AA 2005, opting instead for a less expensive dispute resolution method, given the contractor's cash flow issues.

The main issues before the Court of Appeal are:

1) whether the liquidation of the Contractor renders the arbitration agreement "inoperative" having regard to the acute factor of costs and efficiency in resolving the matter;
2) whether the insolvency regime takes precedence over the arbitration agreement such that all disputes must now be resolved in the Courts and more so when there is allegedly no dispute in the debt claimed;

3) whether there are issues pending which require resolution by an insolvency Court as these are non-arbitrable;
4) whether in spite of the arbitration agreement the Court may have regard to prohibitive costs of arbitration in refusing a stay under s. 10 AA 2005 when the party suing is in liquidation.

Firstly, the contractor's employment under the contract had been terminated by the event of liquidation of the contractor. However, under the doctrine of separability in s. 18(1) and (2) of AA 2005, the arbitration agreement survives the liquidation of the company. When the liquidator commences any action on behalf of the contractor in liquidation, the liquidator steps into the shoes of the company in liquidation and is bound by the terms of the contract including the arbitration agreement, unless the liquidator applies to the Court to disclaim from being bound by those terms. The arguments that arbitration fees would be excessive or that the arbitration process could cause unnecessary delays do not constitute valid reasons to render the arbitration agreement inoperative.

Secondly, the issue of whether insolvency takes precedence over a claim pursued through arbitration or litigation does not arise as they operate on a different plane. Liquidation does not alter the method for resolving disputes, whether through arbitration or, in the absence of arbitration agreement, litigation. Arbitration serves as a means of determining liability and assessing damages for issues covered by arbitration agreement, such as the contractor's claim for the amounts due under interim payment certificates in this case. It is trite law that under s. 10 of AA 2005, it is mandatory for the Court to grant a stay if the matter before the Court is the subject of an arbitration agreement. This principle remains applicable even when the party pursuing the claim is in liquidation.

Thirdly, the contractor's claims and the employer's potential defences, including set-off or counterclaims related to delays, defects, and liquidated damages, are contractual disputes which are arbitrable and not matters uniquely within the domain of a winding-up Court . Some examples of matters that must be addressed by a winding-up Court are those specified in Part I and Part II of the Twelfth Schedule to the Companies Act 2016, as referenced in s. 486 of the Act.

Fourthly, it is insufficient for the contractor in liquidation to claim that arbitration would be slow and costly, draining the company's limited assets and holding up distributions to creditors in the liquidation proceedings, thereby disrupting the efficiency of the liquidation process. In this case, the parties adopted the PAM standard contract and the parties cannot claim that they are not aware of the costs of arbitration. The benefits of arbitration are generally what the parties subscribe to instead of to litigate. Although initial costs of arbitration may appear higher, it must not be forgotten that there is still the element of legal fees and disbursements not costed in. Parties can always explore ways to reduce the costs of arbitration, for example, using chess clock arbitration or documents-only arbitration. Further, arbitral awards are final (save for the limited grounds for setting aside), whereas court judgments are subject to often a few tiers of appeal.

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KEY TAKEAWAYS

Insolvency or receivership alone does not automatically render an arbitration agreement "inoperative". A company in liquidation seeking to avoid arbitration, despite the existence of an arbitration agreement, must demonstrate special circumstances that justify departing from the legislative and judicial preference for holding parties to the arbitration agreement. In exceptional cases, such as where there are multiple overlapping arbitrations that could severely disrupt the insolvency proceedings, the Courts may find arbitration agreements "inoperative".

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